PREFERENTIAL PROPERTY TAX ASSESSMENTS, FARMLAND, AND EQUITY: AN OREGON STUDY

by

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A RESEARCH PAPER

submitted to

Department of Geography

Oregon State University

in partial fulfillment of
the requirements for the
degree of

MASTER OF SCIENCE

May 1985

Directed by
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ABSTRACT. Since the early 1960's, 44 states have passed legislation that offers preferential property tax assessments to farmers. By most accounts, these programs are intended to preserve farmland. Yet, writers on the subject have argued that the preferential assessment simply does not work to prevent the sales of agricultural land. In light of the popularity of the program, a search for a new policy justification has begun. One alternate justification is that the program serves the purpose of redistributing tax burdens toward a more ideal level of equity or fairness. Given a plethora of writings on the farmland preservation goal, the emphasis here is on the equity objective. The history, mechanics and popular issues concerning Oregon's program are examined in order to provide a broader base of knowledge to judge the preferential assessment.

INTRODUCTION

Since the rapid urban growth era following World War II, farm land supplies have declined in the United States. While some people debate whether or not farmland is really a social problem, the majority of state legislatures have decided that the property tax can be modified to preserve farmland. At the present time, 44 states have property tax programs that give a preferential assessment to farmland. Each of these programs is designed to provide tax savings to farmers in the hope that they will keep their land rather than sell it to the highest bidder and/or to simply shift the tax burden away from farmers, based on some concept of equity.

While many studies have evaluated the preferential assessment's effectiveness in preventing farm sales, very few have addressed the program in terms of equity. The intent of this paper is to explain the effects of preferential assessment in terms of equity or concepts of fairness. The first step is to show how the preferential assessment may be considered as a social tool of equity distinct from a social tool of land use. Secondly, it will be shown how the Oregon preferential assessment works to maintain a certain level of equity. Thirdly, while it is clear that the preferential assessment can at least affect the equity of tax burdens in Oregon, it will be argued that some of these effects are not in accordance with traditional views on equity. Finally, some potential modifications of the preferential assessment will be offered that more closely satisfy the traditional goals of equity.

FROM LAND USE TO EQUITY

Two basic themes of research exist concerning the preferential assessment of agricultural land. One is the criticism of the program's effectiveness in preserving farmland from urban sprawl. The other, a much less common approach, is to evaluate the program on its effectiveness in attaining goals of equity. While the emphasis of this paper is on the equity goal, a brief description of past research can help clarify the difference between the two themes, as well as demonstrate the value of using equity as an objective.

Research Under Land Use Goals

The initial situation that stimulated public awareness of the preferential assessment of farmland was the continuing downward spiral of acreage under farmland, in spite of the program. It was estimated that by 1980 the supply of farmland was declining at a rate of 390,000 to 760,000 acres per year. While this estimation does not include the addition of new farmland from technological advances, a consensus among researchers suggests that farmland supplies are declining rapidly (Conrad 1983, 194). The land speculator, according to some, has been given the blame for the decrease in farmland acreage. Economist Philip Raup, in a 1975 article entitled "Urban Threats to Rural Lands," stated that there were some very strong incentives for creditors and developers in the housing market to prefer urban sprawl to compact development. Raup explained that house values depreciate over time while land values appreciate; so, for a sounder investment for the future, the creditor and developer would be in favor of large

lot and surburban development, generally referred to as urban sprawl (Raup 1975, 373).

Despite the decreasing acreage in farmland, the incentives for creditors/developers to purchase land, and the fact that 44 states have passed preferential assessment strategies, the majority of analysts are not convinced that preferential assessment of agricultural land is the appropriate approach to curb urban sprawl. In the widely referenced 1976 Council on Environmental Quality report Untaxing Open Space, it was argued that the main reason for a farmer to sell his land is not based on tax burdens. For example, a survey in New Jersey indicated that the farmer's age, lack of an heir and other social factors were more important than taxes in influencing a farmer to sell his/her land (Regional Science Research Institute 1976, 53). On this basis, a farm tax relief program cannot be expected to halt the sales of farmland.

Other critiques on the effectiveness of the preferential assessment in terms of farmland preservation emphasize the relationship between the landowner and the potential buyer. One argument that is generally representative of several articles on the subject was offered by the regional scientist Neal Roberts in 1980. Roberts identified the major factors involved in a developer's decision to buy land. Assuming that a developer is a rational and profit-seeking individual, he/she will offer a bid that is somewhat less than the discounted net present value of the property. If the landowner sets a price that is considerably less than the developer's future expectations from the land, a sale may occur (Roberts 1980, 4). Roberts said that preferential assessment would not make the farmer

less likely to sell. On land where the property taxes are high, without a preferential assessment the developer's holding costs from the time of purchase to the time of development would be high. In turn, the developer would offer a lower bid for the land. This lower bid might make the farmer less likely to sell the property. Conversely, on land that is preferentially assessed, the developer may project that the preferential treatment might be maintained after the sale, thereby reducing the future holding costs. Consequently, the developer might offer a higher bid for the land. In both cases, the sale will depend largely on the price offered by the buyer, and the price is dependent on the buyer's expected return as well as holding costs. Because the preferential assessment of agricultural land potentially may lower a developer's future holding costs, it may influence the developer's decision to buy, thus induce more sales of farmland--just the opposite of the law's intention (Roberts 1980, 4).

Roberts, the Council on Environmental Quality and others have argued that the preferential assessment should be re-evaluated in terms of its effectiveness in preserving farmland. The basis of their argument lies in the fact that, while the preferential assessment is a benefit to farmers, it is also a cost to non-farmers. Equation 1 shows how the property tax rate rises for all property oweners when the total assessed value is lowered by a preferential assessment on farmland.

$$\text{Tax Rate} = \frac{\text{Desired Revenues}}{\text{Total Assessment Value}} \qquad (1)$$

If the the costs of increased property tax rates to non-farmers cannot be justified on the grounds of preserving farmland, the popularity of

the preferential assessment suggests that some other objective is being served. This other objective, it has been argued, is to redistribute tax burdens in a manner that is in accordance with certain principles of equity or fairness (Ladd 1980, 19-20; Roberts 1980, 6).

Research Under Equity

Since the most past research has been on the preferential assessment's effectiveness in preserving farmland, the equity goals have been largely ignored. This neglect may reflect the fact that equity is a subjective concept that has a variety of interpretations, thereby rendering it less testable by empirical analysis. But there has been some research done to show how the preferential assessment can be considered effective if some common principles of equity are used. These principles apply to the popular perception that farmers are being "taxed out of business."

In 1980, Robert E. Coughlin illustrated in a graph how proponents of the preferential assessment may be justified in the belief that without the program farmers may receive very high tax burdens compared to other landowners (Coughlin 1980, 47).

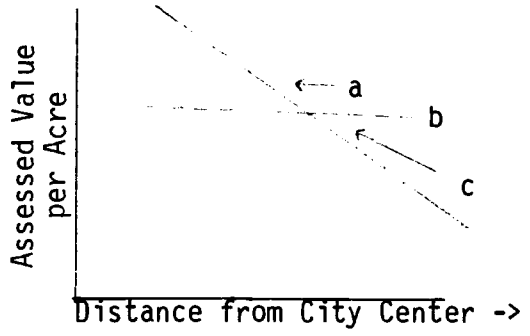

Figure 1. Free market value and farm use value of land by distance from city center. Adapted from Coughlin (1980, 48).

In Figure 1, line a represents the assessments on land based on free market determinations of property value. These assessed values decline as distance from the city center increases. Line b represents a farm use value (preferential assessment) based on the income derived from agricultural land. The basic assumption is that farmland income is less site related than non-farmland income. But given that assumption, without a preferential program, the farmer located near the city may have a much higher tax burden than a non-farmer, in terms of their income or ability to pay. For lands further from the city the difference between the landowners' ability to pay becomes smaller until point c, where market and farm-use value are essentially the same.

Under a preferential assessment program, the farmers could receive a tax savings through lower assessments (represented in Figure 1 as the area under line a and above line b). But to acquire these savings, the farmers need to persuade legislators and other citizens[1] that the distribution of tax burdens would be more equitable with a preferential assessment program than without it. Two arguments are offered in support of this idea. The first, which was alluded to earlier, is that property tax burdens should be in line with the landowners' ability to pay. In most cases, ability to pay is associated with income as the basic criteria. The second argument is that property tax burdens should be in line with the benefits received from property tax financial services (Regional Science Research Institute 1976, 80-81).

To understand the "ability to pay principle," it is helpful to refer back to the explanation of Figure 1. If a farmer near the city center can convince a legislator that his/her tax burden is high compared to another landowner with the same income, he/she may have a strong equity case for preferential assessment. For example, without a preferential assessment two landowners may have the same incomes but if one of them owns farmland he/she may be taxed considerably higher than the other. Dating back to the early 1900's, this equity argument states that if both landowners are of equal "ability to pay" they should, in turn, pay the same taxes (Musgrave 1984, 228). Under the "benefit" principle, if a farmer with a high tax burden could show that other landowners have less tax burdens while all receive the same amount of property tax funded services, the argument for a preferential assessment would be even stronger. In sum, the farmer can have some economic incentive and some ideological justifications of equity to lobby for a preferential assessment.

The link between the preferential assessment and the prevention of farm sales appears to be much weaker than the link between the program and equity objectives. While it may be impossible to determine which perspective is more important in the popular acceptance of the preferential assessment programs, some evaluations of the programs have been made. To date the tendency among writers has been to emphasize the malfunctions of the program under land preservation goals. There is need for analysis of the programs under equity goals.

THE OREGON APPROACH

It is instructive to look at the Oregon preferential assessment program in terms of equity for two reasons. On one hand, the methodology of the Oregon program is generally representative of other states' programs. On the other hand, the Oregon program is situated in a uniquely complex state policy for land use planning, which helps to illustrate the real and potential equity implications.

History and Intent

The first version of a preferential assessment program was approved by the Oregon legislature in 1961. In the Oregon Revised Statutes, sections 308.237 and 308.238, the law stated that zoned farmland would be assessed at its true cash value for farm use. Thus, the preferential assessment was termed a "use-value assessment." The law provided that under certain conditions the farmer could get a lower than market value assessment. To be eligible, the farmer was required 1) to own at least five acres of land and 2) to have that land within an agricultural zone. While the acreage limitation did not generate a great deal of conflict over issues of fairness, the zoning requirement did, and it caused the eventual repeal of the law. The fact was that most of Oregon was unzoned and the majority of farmers felt they were being treated unfairly by the law (Sullivan 1973, 9).

After the repeal of ORS 308.237 and 308.238 in the 1963 legislative session, a new use-value assessment law was passed that included both zoned and unzoned farmland. This law retained the five-acre size limit for qualification of farmlands but added a twist

to the zoning requirement. Upon application for use-value status, the owner of unzoned farmland had to agree that he/she would pay a penalty or a rollback charge if farming ceased on the land or if the land was sold to a non-farmer. This penalty was based on the difference between the use-value and the market value for every year since the land was first given use-value status (up to 5 years). Landowners of zoned farmland were exempt from any deferred penalties (1963 ORS 308.370-308.395, 215.203, 215.213).

Minor changes were made to the 1963 law in the 1965 legislative session, but significant changes were made in 1967. Simply having five acres of land and demonstrating a farm use was no longer adequate. Under the 1967 legislation, the owner of unzoned farmland had to demonstrate that a minimum of $500 of gross income was earned through agricultural use of the land (Sullivan 1973, 13).

The basic framework of the current preferential assessment legislation combines both the 1963 law and tenets of the 1967 law. Since the passage of Senate Bill 100 and the statewide planning goals in 1973, zoned farmland has been referred to as Exclusive Farm Use zones (EFU's). Land within these EFU's is automatically assessed at a use-value and is subject to a deferral penalty (1983 ORS 308.399; see Appendix A). Landowners of unzoned farmland must meet strict income standards. To qualify under the law, a farmer who owns a unit of land smaller than five acres must earn at least $500 of gross income from it. On units larger than five acres but not more than twenty acres, at least $100 of gross income per acre must be shown, and on units larger than twenty acres the minimum requirement is $2,000 of total

gross income. Unzoned farmland is also subject to a deferral penalty which consists of a rollback charge of the deferred assessed value multiplied by the number of years enrolled in the program (up to 10 years) plus an interest rate (1983 ORS 308.399; see Appendix A).

Considering the legislative changes since 1961, it can be seen that the use-value assessment has been viewed as more than simply a tool to preserve farmland. The program has been expanded to include the majority of the state's farmers and modified to more closely target the "bona fide" farmer. Both changes have been made to improve the fairness of the program's administration. The stated intent of the program illustrates how these changes have come about.

> It is the legislative intent that the bona fide (farm) properties shall be assessed at a value that is exclusive of values attributable to urban influences or speculative purposes. (1983 ORS 308.345)

The intent can be interpreted as a blanket rejection of free market-based assessments on "bona fide properties." Thus, the program has been broadened to include more farmers since 1961. But the term "bona fide" suggests that only certain commercial farmers are eligible. The stricter minimum acreage and income qualifications passed in 1967 are representative of the attempt to target these commercial farmers.

Initially, the legislative history of Oregon's use-value assessment may appear rather straightforward. The intention has been to give lower assessments on "bona fide" properties. However, "bona fide property" is not an absolute or mutually exclusive definition of a land use practice. For example, a person whose income is received mostly from non-farm sources may be just as qualified for a use-value

assesssment as a person whose income is derived from farming. There is nothing inherently wrong with a landowner generating income from both farm and non-farm sources; in fact, most farmers do (Census of Agriculture 1978, 3)[2]. Because this is the case, it is difficult to distinguish between landowners who should receive tax benefits and who should pay for the benefits. This situation will be discussed in greater detail later.

Planning Framework

In 1973 a statewide planning program was created by the passage of SB 100 by the Oregon legislature. One part of this act established the Exclusive Farm Use zones (EFU's). These zones are chosen by the local governing body and are included in the state mandated comprehensive plan of the locality. The plan and the respective EFU zones are reviewed by the state's Land Conservation and Development Commission so that the soil classes and types of agricultural use are consistent with the predetermined statewide planning goals (Gustafson et al. 1982, 336-367).

Goal 3 of the Oregon law (SB 100) is "to preserve and maintain agricultural lands." This goal has been linked to the use-value assessment program in ORS 215.243, which states:

> Exclusive farm use zoning as provided by law, substantially limits alternatives to the use of rural land and, with the importance of rural lands to the public, justifies incentives and privileges offered to encourage owners of rural lands to hold such lands in exclusive farm use zones. (1983 ORS 215.243)

This law justifies the use-value assessment of lands within an EFU zone without any acreage or income qualifications. Specifically, the lack of land use alternatives inherent in the zoning designation

justifies the tax savings as encouragement to keep the land under EFU status. So while the use-value assessment law and the state zoning laws are designed to stand alone, the two laws are interrelated (Pease 1982, 547).

Some authors have argued that the combination of the use-value assessment and the EFU zone has been successful in preserving agricultural land (Banta 1980, 82). Indeed, the rate of farm turnover has declined dramatically in Oregon since the late 1960's and early 1970's (Furuseth 1981, 1). However, there is no evidence to show that the two laws in combination or separately have had any effect on the land use behavior of farmers, as opposed to the effects of land values, crop prices, etc. What the EFU zoning can at least provide is assistance in the identification of the beneficiaries of a use-value assessment via the political process of the local government.

In sum, both zoned and unzoned farmlands are recognized by the Oregon use-value assessment laws. Zoned farmland is determined by soil type, land use, and the political decisions of the local governing body, and unzoned farmland is determined by land use, gross income, and minimum acre size. This is a result of the legislative attempt to accurately distinguish between the recipients and the providers of property tax relief.

If it is assumed that the identification of recipients (farmers) and providers (non-farmers) is a relatively simple process, the resulting tax shifts of the use-value program can be shown and the change in the distribution of tax burdens can be shown in terms of

equity principles. But, considering the very real difficulties in distinguishing between farmers and non-farmers, discussion of the changes in tax burdens becomes much more complex.

Mechanics of the Use-Value Assessment

The use-value assessment affects the landowners by redistributing the tax burdens within a taxing unit. This redistribution of property tax burdens is dependent on the following parameters: 1) the tax base of the taxing unit, which is the total assessed value of all land and non-land property; 2) the number of landowners under use-value status; 3) the amount of land under use-value status; and 4) the difference between total use-value assessments and market value assessments (Dunford & Marousek 1981, 222). To clarify these points it is helpful to exemplify the process by using a fictitious taxing unit whereby the distribution of tax burdens will be shown before and after a use-value assessment on farmland.

As was shown earlier, the tax rate (R) of a taxing unit equals the desired revenues (T), divided by the total assessed value, i.e., tax base (B):

$$R_1 = \frac{T}{B}$$

Therefore, if desired revenues are $1 million and the tax base is $5 million, made up of $3 million of assessed value in farmland and $2 million in assessed non-farm property, the tax rate equals .2. In turn, taxes on farmland would be $600,000 ($3,000,000 x .2) and on non-farm property, $400,000 ($2,000,000 x .2). It is assumed in this case that the farm and the non-farm property are assessed at the true cash value of the land. The distribution of tax burdens would

theoretically follow line a on Figure 1. Those landowners near the city center may be paying taxes per acre of land that are larger than taxes paid by landowners further from the city, regardless of income levels.

With the implementation of a use-value assessment, farm property owners can be given non-market assessments which will change the tax base (B) of the taxing unit. This change is defined by the difference between the total market based assessed value on farmland (m) minus the total use-value assessments on farmland (u). The difference (D) between these two values is subtracted from the initial tax base (B) of $5 million to determine the new tax base with the use-value assessment program (B - D). If it is assumed that desired tax revenues are the same as they were without the program, and that use-value assessments on farmland are 50 percent of what market based assessments would be, the tax rate increases and the burden of payments shifts. The following illustrates these changes.

Ex. 1:

$$R = \frac{1{,}000{,}000}{B - D} \qquad (2)$$

where: $D = 3{,}000{,}000 - 1{,}500{,}000$
$= 1{,}500{,}000$; and

$B - D = 5{,}000{,}000 - 1{,}500{,}000$
$= 3{,}500{,}000$

$R = .28$

The new tax rate of .28 would change the distribution of tax payments to $420,000 on farm property and $560,000 on non-farm property. Payments increase for non-farmers and decrease for farmers due to the use-value assessments. The degree of this tax shift is affected primarily by the characteristics of the factor D.

amount of use-value assessed farmland compared to market assessed land. Therefore, if a taxing unit's tax base consists mostly of use-value assessed land and if the use-value assessment is a small percentage of market value assessments, the shift would be large. Conversely, if the tax base is made up of few properties assessed at use-value, the tax shift would be smaller. In sum, the use-value assessment can shift the tax burden from farm properties to non-farm properties in a way that responds to the difference between market values and use-values and in a way that responds to the amounts of farmland (% of tax base) within a taxing unit.

In terms of equity, the use-value assessment is ideally intended to redistribute income toward farmers as a group because they earn less than non-farmers--25 percent less according to a Special Census Report made in 1982 (U.S. Bureau of the Census 1983, 11). In the previous example, it was shown how the use-value assessment can shift the tax burden away from farmers and thus compensate for the difference in incomes between farmers and non-farmers. However, the actual redistribution of tax burdens from the use-value assessment is not as simple as this would imply.

USE-VALUE ASSESSMENT AND EQUITY

To understand the equity implications of the use-value assessment, one critically important fact must be recognized: Farmland, like many other natural resources, is defined by social, political and legal decisions that reflect the needs of society. Drawing from Erich Zimmermann's (1964) Introduction to World Resources, farmland may be perceived as a resource that defies any

objective definition (p. 8). As times and people have changed, perceptions and definitions of farmland have changed. Nonetheless, in order for the use-value assessment to distribute the burdens of the property tax according to any equity rule, "bona fide" farmland must be identified. Therefore, farmland must be defined (Ecker-Racz 1970, 94).

The Oregon definition of "bona fide" farmland is based on the qualifications of an EFU zone and for a use-value assessment (see Appendix B). Basically, any land that meets the EFU zoning requirements or that meets the parcel size and income requirements for a use-value assessment is by definition classified as "bona fide farmland." Thus, bona fide farmland owners represent a large group of beneficiaries of tax relief from the use-value program. Yet, it is obvious that not all bona fide farmers are identical. A broad variation in farm income/non-farm income, intensity of agriculture, value of land, etc. is common in Oregon. The variation in types of farmland and farmers becomes important when the definitional requirement of the use-value assessment is considered.

Several problems exist with the application of use-value assessment to farmlands. These problems are addressed in the following three sections: Entrance Qualifications, Variation of Assessed-Use Value and Market Value, and Distribution of Benefits and Costs. The first two sections emphasize the equity implications among different types of farmers within taxing units; the third addresses the broader equity issues relating to all landowners in Oregon.

Entrance Qualifications

Given the potential savings of a farm near the urban boundary that receives a use-value assessment, it is not surprising that many landowners attempt to get use-value status. Because of the variety of farms and intensities of traditional farming practices, the definition of "bona fide" farm use under the law has become nearly all-encompassing (see Appendix B). Nearly any parcel, within any zone, that is able to produce $500 of gross income per acre for one year can be qualified for a use-value assessment.

A study made by the Bureau of Governmental Research (1979) in Eugene, Oregon, showed that several cases existed in the Eugene/Springfield urban service area in which non-traditional farmers were considered bona fide farmers under the law. In one case, a 280-acre parcel in the planning stages of becoming a planned unit development and zoned "tract" was eligible for the use-value assessment. The parcel was classified as pasture land under the law and was assessed at a use-value of $250. If the land had been assessed at the residential rate, the tax would have been $120,000 (Bureau of Governmental Research 1979, 10).

In addition to developers being classified as bona fide farmers under the use-value assessment, small-scale "hobby farmers" can qualify for a use-value assessment. In a 1984 position paper adopted by the Oregon Association of County Planning Directors, it was stated that "many owners of small tracts are taking advantage of the farm value assessment program to obtain significant property tax reductions" (OACP 1984). This concern was based on the ease with which landowners can meet the minimum gross income standards for

use-value assessments.

The examples of the developer and the hobby farmer represent two extreme variations in the type of landowner that can be classified as a bona fide farmer. The problems associated with these examples are explained by the "ability to pay" principle of equity. If a landowner's intention is not to farm the land for a profit, but to simply meet the minimum prerequisite for use-value status, then other landowners, farmers as well as non-farmers, must bear the burden of the costs of higher tax rates. But, most importantly, the situation can arise where two "bona fide" farmers, one whose farming is a "hobby" and the other whose sole income is from farming, have the same income but are taxed without regard to their income. This situation is examined more thoroughly in the next section.

Variation of Assessed Value and Market Value

The work done by Robert Coughlin showed that market based assessments are generally site related. Conversely, the use-value assessment per acre is more consistent across a geographical region. In turn, the potential tax savings from a preferential assessment to a farmer can vary depending on where the property is located and how the property is assessed.

Under Oregon law there are two methods used to assess the use-value of farm property. The first is the comparable sales approach, whereby the assessor uses sales data of similar parcels to determine the assessed value per acre. Due to a lack of sufficient sales for comparison, assessors rarely use this approach.[3] The second and more common approach is the capitalization of net farm income from an acre of land (Regional Science Research Institute 1976, 224). The

formula for this calculation is as follows:

$$AV = \frac{I}{C + r} \qquad (3)$$

where: AV = assessed use-value

I = net farm income

C = capitalization rate chosen by the Oregon Department of Revenue

r = local property tax rate

The assessed use-value will vary depending on the types of crops, livestock, etc., and farmers will receive different use-value assessments depending on the size, location, and market value of their parcels of land. Likewise, the degree of the tax shift will be affected by the variation in use-value assessments. In reconsidering the earlier tax shift example, assume that only two farmers made up the $3 million in assessed market value, and each owns $1.5 million worth of assessed property If farmer A happens to live near a development project and his assessed use-value is 20 per cent of his market assessed value, under the program he would have an assessed value of $300,000. If farmer B's use-value was 50 percent of his market assessment, his assessment would be $750,000. Total assessed use-value would equal $1,050,000. The difference (D) between $1,050,000 and the market based assessment on farmland of $3,000,000 is $1,950,000, which can be entered into equation 2 of the earlier tax shift model.

Ex. 2:
$$R = \frac{1,000,000}{5,000,000 - 1,950,000}$$

$$R = .33$$

With a tax rate of .33 under the use-value program, farmer A would pay

$99,000 and farmer B would pay $247,500, for a total of $346,500 for both farmers (1,050,000 x .33). Non-farmers would pay $660,000 (2,000,000 x .33).

Under a use-value assessment program, farmer A's taxes are considerably lower than they would be under a market value assessment program, and they are considerably lower than farmer B's taxes. Both farmers could conceivably have the same incomes, therefore equal under the "ability to pay" principle, yet both may have very different tax burdens. In fact, farmer A may be able to pay more than farmer B because he would have more collateral to borrow money. Admittedly the example has generalized the problem a great deal and it is not meant to suggest a farmer should have to borrow money to pay taxes. But the example does show that the program can shift the tax burden without regard to the "ability to pay" principle because the use-value assessment process does not distinguish between different types of farmers in different locations.

The Distribution of Benefits and Costs

The tax shift examples using equation 2, particularly Example 1, showed that the tax rate is affected by the total assessed value and the mix of farmland and non-farmland within a taxing unit. In turn, total property taxes paid will vary across different taxing units, whereby each taxing unit's total taxes are affected differently by the use-value assessment. Consider two examples, one in which a taxing unit is dominated by farm use and a second in which non-farm use is dominant. Under the use-value assessment the burden from the market value assessment is shifted from farmers to non-farmers in both cases. But, in the taxing unit where farm use is dominant, the few non-farmers

will receive a heavier burden than the non-farmers in the other taxing unit. The main reason for this is that in units with many use-value assessed properties (farmers) the costs from the lower assessment are shifted to the few non-farmers. Likewise, the taxing unit that is predominately under non-farm use will shift smaller burdens onto non-farmers. Thus, the portion of total property taxes that is attributable to the use-value assessment program will vary from taxing unit to taxing unit.

The variation in property taxes attributable to the use-value assessment program, i.e., costs, is seen by some authors as a logical result derived from the unique characteristics of a particular taxing unit. Drawing from the benefit principle, Lindholm et al. (1979, 35) argued that the variation in costs is justified by the variation in property tax-funded services in different taxing units. Ladd (1979) expanded upon the benefit principle but reached very different conclusions on the justification of the use-value assessment. The view held by Ladd and others is that benefits and costs should be looked at from a broader perspective than just within the taxing unit. Ladd (1979) argued that the benefits of the use-value program in fact reach further than only the farmers within a taxing unit, whereas the costs are targeted to only non-farmers within the unit (p. 35). This implies that all citizens benefit in having use-value assessment, whether from aesthetic desires to preserve open space or simply an altruistic desire to shift tax burdens away from farmers.

As was discussed earlier, the benefit principle essentially says that people should be taxed according to the amount of property tax-funded services they receive. In terms of the use-value

assessment, this translates into the idea that farmers should get tax relief because they require fewer services than non-farmers. While this view is debatable, it clearly illustrates that under the benefit principle of equity some attempt is made to align the benefits of public service to the costs of property tax payments within a taxing unit. According to the benefit principle, the benefits should be accounted for through tax payments. Under the current use-value assessment, the benefits to citizens outside the taxing unit represent a spillover cost to those non-farmers within a taxing unit. For example, urban residents may derive some satisfaction from farmers receiving tax relief, but since there are no use-value properties within their tax code area, they receive benefits at the expense of landowners within taxing units that have use-value assessed property.

What Can Be Done?

To briefly summarize the equity issues relating to the use-value assessment, it was that: tax benefits or savings can be allocated without regard to ability to pay; tax burdens can be shifted to farmers as well as to non-farmers; and under the benefit principle of equity, non-farmers may receive additional burdens because some urban residents receive benefits at no cost. The first two issues are inherently based on the problem in identifying bona fide farmland; the latter issue is based on the more ideological problem of fiscal federalism. These problems are difficult to resolve, but some potential responses to them can be identified.

The Oregon Association of County Planning Directors has offered a variety of ways to address the first problem, i.e., the identification of bona fide farmland (see Appendix C). One of the methods suggested

is to change the use-value assessment program's eligibility requirement of $500 of gross income. Specifically, it would require that the purchase price of livestock be deducted from the gross income. This would prevent a landowner from meeting the minimum income qualification in a single transaction of buying and selling a few head of livestock. Since livestock sales qualify many farmers on unzoned farmland for the program, this approach would keep some landowners out of use-value status (OACPD 1984, 1).

The planners also suggested that the current acreage and income eligibility requirements that exist on unzoned farmland should be applied to EFU lands. This would remove the automatic use-value assessment on EFU lands and require farmers in those zones to demonstrate a farm income in the same manner as non-zoned farm owners. Currently proposed as HB 2232 (see Appendix D), this approach could keep some landowners out of use-value status and thereby prevent unnecessary tax burdens on other landowners.

Both of these suggestions would improve the administration of the use-value assessment given the established criteria for identifying bona fide farmalnd, i.e., income and acreage requirements. But, even if the current cirteria is improved, implemented and enforced, some landowners, e.g., developers, will be able to provide only token farming efforts to receive tax savings. In turn, tax burdens due to the use-value assessment can still be shifted away from those who may be most able to pay. Thus, the problem relates back to the criteria used to distinguish whether or not a farm is bona fide.

Ecker-Racz argued that a more direct approach in distinguishing between farmers and non-farmers is logical as well as possible.

Alaska, for example, defines farmland as land that the owner receives at least one-fourth of his/her income from an agriculture use (Ecker-Racz, 1970, 95). In Oregon this type of criterion for identifying bona fide farmland could remove many of the landowners who may not be traditionally considered as farmers and make the use-value assessment more responsive to the ability to pay of landowners.

Concerning the situation in which Ladd suggested that benefits from the use-value program are received at no cost by residents in taxing units with no farmland, Oregon can learn from other states' attempts to broaden the program's tax base. The most common way to charge all of the beneficiaries of the use-value program has been to finance tax relief to farmers from the state income tax, commonly called a circuit breaker. Based on studies made on the application of a circuit breaker in other states' programs, the advantages appear to be twofold. First of all, the financing based on an income tax (based on farm receipts) may provide a better indicator of the ability to pay than the current dependence on land values (Lockner & Kim 1973, 238). Secondly, all taxpayers would to some degree pay for the tax relief allocated to farmers. The most difficult question would be in determining how much, for example, an urban resident should contribute. Oregon income taxes are currently higher than the national average (Kelly & Weber 1984, 3) and current sales tax proposals intended to lower income tax burdens make it unlikely that voters would approve any further increase in state taxes. Nonetheless, this approach may provide an alternative for Oregon in the future.

SUMMARY AND CONCLUSION

The nationwide popularity of preferential property tax assessments began in the 1960's with the public's heightened awareness of decreasing farmland acreage. It remains to be seen whether the preferential assessment was originally intended to serve a policy goal of farmland preveration, tax relief, or a combination of both. Most studies relating to the preferential assessment have emphasized its inability to preserve farmland. If those studies are accurate, the next logical step is to investigate the preferential assessment's justification as a tax relief measure. On only rare occasions has the preferential program been examined from this perspective.

A prerequisite to any tax relief measure is that the beneficiaries and the contributors be identified. In terms of the preferential assessment, farmland must be distinguished from non-farmland. If this can be accomplished, the preferential program must then be evaluated on its ability to shift tax burdens away from farmers based on some accept concept of equity. Equity has traditionally been based on two principles: the ability to pay and the benefits that equal taxes.

Examination of the Oregon use-value assessment program has shown that since 1967 two criteria exist for identifying bona fide farmland. The land must be zoned EFU or it must meet certain income and acreage requirements. Given several years of modifications, the use-value assessment has more closely targeted the landowners that meet the established criteria. However, when the program is applied, it can be seen that tax burdens are not necessarily shifted away from those least able to pay and that some people may receive benefits at no cost.

This report has shown that:

1. Certain "bona fide" farmers, i.e., hobby farmers and developers, who are presumably very able to pay, may be taxed less than others with less ability to pay.

2. The use-value assessment compared to market value assessment can shift tax burdens not only from farmers to non-farmers but from certain farmers to other farmers as well, depending on the location of the property, regardless of the ability to pay.

3. There may be additional tax burdens on residents of taxing units that have farmland within their boundaries because of the benefits at no cost received by residents in totally urban taxing units.

Each of these situations reflect on the problem of identifying the beneficiaries and the contributors of the tax relief measure. More specifically, they relate to the criteria used to define bona fide farmland. The inherent variation in people's perceptions of farmland makes the categorization of farmers and non-farmers very difficult, and under the current criteria for defining farmland, there is some grounds for objecting to the program based on equity principles.

The Oregon program could be modified to more accurately classify farmers and non-farmers given the current income and acreage criteria, but it is also possible to change the criteria and redefine "bona fide farmland." Other states are dealing with equity implications and are using new definitions of farmland. Policymakers and citizens of Oregon might benefit from keeping an eye on these programs and possibly reconsider the goals concerning the use-value assessment.

Footnotes

1. Relying on the economic theory of the "median voter model" (see Musgrave and Musgrave 1984, 104-105), farmers are a minority and would need the support of other voters ("citizens") to pass a preferential tax program.

2. In 1978 the Bureau of the Census estimated that approximately 62 percent of farmers worked off the farm for more than one day a year, 59 percent for more than 49 days per year (Census of Agriculture 1978, 3).

3. The comparable sales approach is only used if purchases have been made by "prudent investors." A prudent investment is defined by ORS 308.345, which generally states that the buyer must have a "reasonable expectation" that the average annual return from the land will not be less than the current rate of interest charged by the Federal Land Bank on first mortgages on farmland.

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APPENDICES

308.399 Penalty when land disqualified for special assessment; exception to penalty assessment. (1) Except as otherwise provided in subsections (3) and (4) of this section, when land which has received special assessment as farm use land under ORS 308.370 (1) thereafter becomes disqualified for such assessment under ORS 308.397, the assessor shall notify the owner thereof and there shall be added to the tax extended against the land on the next general property tax roll, to be collected and distributed in the same manner as the remainder of the real property tax, an additional tax equal to 10 times (or such lesser number of times, corresponding to the years of farm use zoning applicable to such property) the total amount by which the taxes assessed against the land would have been increased if it had been valued without regard to ORS 308.370 (1) during the last year beginning after October 5, 1973, in which such farm use assessment was in effect for the land.

(2) The amount determined to be due as an additional tax under subsection (1) of this section may be paid to the tax collector prior to the completion of the next general property tax roll, pursuant to ORS 311.370.

(3) No amount shall be imposed under subsection (1) of this section upon an owner of land that has received special assessment as farm use land under ORS 308.370 (1), if the land becomes disqualified for such special assessment because:

(a) The land is acquired by a governmental agency as result of the lawful exercise of the power of eminent domain or the threat or imminence thereof; or

(b) The land ceases to be located within the boundaries of an exclusive farm use zone as the result of a change in the boundaries of the zone or removal of the zone following an action by the governing body of the county that was not requested or initiated by the owner of the land.

(4) In making the computation of additional tax or penalty under subsection (1) of this section, the phrase "five times" shall be substituted for the phrase "10 times" if the land, upon disqualification for special assessment is located within an urban growth boundary.

(5) As used in this section, "urban growth boundary" means an urban growth boundary contained in a city or county comprehensive plan that has been acknowledged by the Land Conservation and Development Commission pursuant to ORS 197.251 or an urban growth boundary that has been adopted by a metropolitan service district council under ORS 268.390 (3). [1973 c.503 sec.6; 1979 c.350 sec.6; 1981 c.791 sec.4]

(Source: Oregon Revised Statutes 1983, p. 109.)

215.203 Zoning ordinances establishing exclusive farm use zones; definitions. (1) Zoning ordinances may be adopted to zone designated areas of land within the county as exclusive farm use zones. Land within such zones shall be exclusively for farm use except as otherwise provided in ORS 215.213 or 215.283. Farm use zones shall be established only when such zoning is consistent with the comprehensive plan.

(2) (a) As used in this section, "farm use" means the current employment of land for the primary purpose of obtaining a profit in money by raising, harvesting and selling crops or by the feeding, breeding, management and sale of, or the produce of, livestock, poultry, fur-bearing animals or honeybees or for dairying and the sale of dairy products or any other agricultural or horticultural use or animal husbandry or any combination thereof. "Farm use" includes the preparation and storage of the products raised on such land for human use and animal use and disposal by marketing or otherwise. It does not include the use of land subject to the provisions of ORS chapter 321, except land used exclusively for growing cultured Christmas trees as defined in subsection (3) of this section.

(Source: Oregon Revised Statutes 1983, 414)

. . . . . .

308.372 Qualifications for exclusive farm use; gross income; acreage; penalties for failure to notify assessor of noncompliance. (1) For purposes of ORS 215.203, 215.213, 215.283 and 308.345 to 308.403, farmland that is not within an area zoned for farm use under ORS 215.010 to 215.190 and 215.402 to 215.438, is not used exclusively for farm use unless in three out of the five calendar years immediately preceding the assessment date the farmland was operated as a part of a farm unit that has produced a gross income from farm uses in the amount provided in subsection (2) of this section. As used in this section, "gross income" includes the value of any crop or livestock that is used by the owner personally or in his farming operation, but shall not include the value of any crop or livestock so used unless records accurately reflecting both value and use of the crop or livestock are kept by the owner in a manner consistent with generally accepted accounting principles. The burden of proving the gross income of the farm unit for the years described in this subsection is upon the person claiming special assessment for the land.

(2)(a) If the farm unit consists of less than five acres, the gross income amount required by subsection (1) of this section shall be at least $500.

(b) If the farm unit consists of five acres but does not consist of more than 20 acres, the gross income amount required

by subsection (1) of this section shall be at least equal to the product of $100 times the number of acres and any fraction of an acre of land included.

(c) If the farm unit consists of more than 20 acres, the gross income amount required by subsection (1) of this section shall be least $2,000.

(d) In arriving at the number of acres for purposes of this section, the land described in ORS 215.203 (2)(b) and the land, not exceeding one acre, used as a homestead shall not be included.

(Source: Oregon Revised Statutes 1983, 105)

Appendix C

The following is an excerpt of an unpublished position paper entitled Farm Value Assessment Program Changes, adopted by the Association of County Planning Directors, November 29, 1984:

Since the advent of the State Land Use Goals counties have been required to place large areas of rural land in EFU zones and to impose restrictions on creation of new non-farm parcels and homesites. Properties in an EFU zone can qualify for assessment at farm value if the property is in "farm use." There is evidence that many owners of small tracts are taking advantage of the farm value assessment program to obtain significant property tax reductions. Counties are finding it difficult to justify the use of the commerical agricultural standard to judge proposals for new farm parcels or dwellings and imposition of paybacks and penalties for new non-farm dwellings, when others, who already have a dwelling, are able to obtain a property tax reduction without being commercial farmers.

POSITION: The County Planning Directors support legislation that addresses the following concerns.

The farm valuation program allows a property owner in a non-farm zone to meet the income test and have property assessed at farm value on the basis of the gross sales price of livestock. The owner can purchase and resell a few head of cattle the same day and meet the income test. There is evidence that most properties in non-farm zones that qualify for special assessment qualify on the basis of livestock sales.

POSITION: The County Planning Directors support changes that will eliminate this abuse of this program. One way to achieve this is to require the deduction from gross income of the purchase price of the livestock.

In farm zones there are many tracts that are smaller than the typical size of commercial agricultural operations. If those lands are put to farm use the Assessors must assess the land at farm value. Minimal farming activity is enough to remain qualified. This results in a significant reduction in the assessed value of land in farming zones and shifts the tax burden to urban and rural landowners who are not on farm deferral.

POSITION: The County Planning Directors feel strongly that "farm use with the primary purpose of obtaining a profit" is too easy a standard for special assessment compared to the intent of farm zones to maintain commercial agriculture. One way to correct this is to apply the income test in farm zones on substandard size parcels with a dwelling. A substandard parcel is smaller than the minimum parcel size in the applicable zone or smaller than 20 acres in a farm zone with no minimum lot size.

Appendix D

The following item entitled "Bill restricts hobby farms," written by Foster Church, appeared in The Oregonian, April 25, 1985, page C12:

SALEM -- Small "hobby farms" would have three years to start producing cash crops or their property taxes would go up under a bill approved Wednesday by the House Revenue Committee.

The Committee approved HB 2232, which would make it more difficult for owners of small farms to claim farm use assessments for property tax purposes if their property does not actually produce farm income.

The measure, which is controversial because of the growing number of small-farm owners in the state, has an array of different forces for and against it, and even farm organizations are not of one position.

The Oregon Farm Bureau opposes the bill. But the committee heard testimony from other farmers not associated with the bureau who support the bill on the grounds that when non-producting farms get the same tax treatment as working operations, tax rates rise accordingly.

The bill as it is now written would apply an income test to farms in order to get farm use assessments. At a minimum lot size of 20 acres, an owner would have to produce a gross farm income of at least $2,000 to qualify.

Smaller properties, up to five acres, would have to make about $100 an acre to be eligible. Farms of five acres or less would have to make $500.

The bill would apply stricter guidelines to the land beneath a homestead site. In order to for it to be eligible, the property would have to produce $5,000 in gross farm income.

Taxation of farm land has been controversial, since farm lands in exclusive farm use zones -- particularly those close to urban areas -- yield so much more tax revenue when assessed at market rather than farm value.

The Legislative Revenue Office estimates that if property is assessed for farm use at $200 to $300 an acre, often its market value could be $1,000 or more an acre.

The effective date for the bill would be 1988, which would give owners of non-working farms time to produce the necessary income to meet farm assessment requirements.